IT 98-0094-GIL 12/01/1998 UNITARY

General Information Letter: Application of 80-20 test to federal From 1120F filer.

December 1, 1998

Dear:

This is in follow-up to the Department's letter sent to yourself on August 11, 1998 in response to your letter dated July 23, 1998. After reviewing the Department's previous letter it was found that an oversight was made. As Entity B is protected by treaty, a different analysis is necessary. I apologize for this inconvenience and hope that this GIL will serve your needs better. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of agency policy that apply, interpret or prescribe the tax laws and are not binding on the Department. For your general information we have enclosed a copy of 2 Ill. Adm. Code Part 1200 regarding rulings and other information issued by the Department.

Although you have not specifically requested either type of ruling, the information you have provided requires that we respond with a general information letter.

In your request you stated:

> I represent two entities with corporate income tax nexus in the state of Illinois. Both entities are controlled by the same German corporation.
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> Entity A is a New York State Corporation. Its parent company is in Germany and it is a wholly owned (100%) subsidiary of this German parent company. Entity A has nexus in the state of Illinois because it has an employee and office rent in Illinois. Entity A will have a three factor Illinois allocation of about 3.25%. Entity A files Form 1120 for purposes of the Internal Revenue Service and is not part of any consolidated tax return or federal affiliated group.
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> Entity B is a German Corporation registered to do business in the state of Illinois. Entity B files Form 1120F with a 6114 Disclosure Statement for Federal purposes stating that is immune from IRS tax because it has an office and three employees in Illinois. This German corporation doing business in Illinois is a subsidiary of the parent company located in Germany of Entity A. Entity B has an Illinois allocation of 0.01%.
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> Thus, Entity A and Entity B have the same German Parent company. Entity A and Entity B share an office in Illinois. Entity A and Entity B have no intercompany sales. The president of Entity A is

located at the corporation headquarters of Entity A in New York State. The president of Entity B is located in Germany.

The question is if Entity A and Entity B form an Illinois unitary group. If so, is an Illinois combined report needed? Keep in mind that Entity B is not a United States taxpayer and has over 99% of its activity outside the United States.

Department Analysis

For Illinois income tax purposes, combined reporting is required when two or more persons [i.e. businesses] are engaged in a unitary business as described in section 1527(a)(27) of the Illinois Income Tax Act ("IITA"). Section 1527(a)(27) defines a unitary business as:

> a group of persons related through common ownership whose business activities are integrated with, dependent upon and contribute to each other. The group will not include those members whose business activity outside the United States is 80% or more of any such member's total business activity; for purposes of this paragraph and clause (a)(3)(B)(ii) of Section 304, business activity within the United States shall be measured by means of the factors ordinarily applicable under subsections (a), (b), (c), and (d) of Section 304 except that, in the case of members ordinarily required to apportion business income by means of the 3 factor formula of property, payroll and sales specified in subsection (a) of Section 304, such members shall not use the sales factor in the computation and the results of the property and payroll factor computations shall be divided by 2 (by one if either the property or payroll factor has a denominator of zero).

35 ILCS §1527(a)(27) (full text enclosed)
Section 304(c) then explains the mechanics of how a financial organization computes its business income. Section 304(c) states in part:

> **(c) Financial Organizations.**
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> (1) In general. Business income of a financial organization shall be apportioned to this State by multiplying such income by a fraction, the numerator of which is its business income from sources within this State, and the denominator of which is its business income from all sources. For the purposes of this subsection, the business income of a financial organization from sources within this State is the sum of the amounts referred to in subparagraphs (A) through (E) following, but excluding the adjusted income of an international banking facility as determined in paragraph (2):
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> (A) Fees, commissions or other compensation for financial services rendered within this State;
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> (B) Gross profits from trading in stocks, bonds or other securities managed within this State;
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> (C) Dividends, and interest from Illinois customers, which are received within this State;

(D) Interest charged to customers at places of business maintained within this State for carrying debit balances of margin accounts, without deduction of any costs incurred in carrying such accounts; and

(E) Any other gross income resulting from the operation as a financial organization within this State. In computing the amounts referred to in paragraphs (A) through (E) of this subsection, any amount received by a member of an affiliated group (determined under Section 1504(a) of the Internal Revenue Code but without reference to whether any such corporation is an "includible corporation" under Section 1504(b) of the Internal Revenue Code) from another member of such group shall be included only to the extent such amount exceeds expenses of the recipient directly related thereto.

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(C) Change to Consolidated Report of Condition and in Qualification. In the event the Consolidated Report of Condition which is filed with the Federal Deposit Insurance Corporation and other regulatory authorities is altered so that the information required for determining the floor amount is not found on Schedule A, lines 2.c., 5.b. and 7.a., the financial institution shall notify the Department and the Department may, by regulations or otherwise, prescribe or authorize the use of an alternative source for such information. The financial institution shall also notify the Department should its international banking facility fail to qualify as such, in whole or in part, or should there be any amendment or change to the Consolidated Report of Condition, as originally filed, to the extent such amendment or change alters the information used in determining the floor amount.

In your letter you stated that Entity B was a German corporation protected by treaty arrangements between the United States and Germany. Furthermore, Entity B has over 99% of its activity outside of the United States. If this is true, then for IITA purposes Entity B **would** apply the "80-20 test" but use in the denominator only the business income which is attributable to its U.S. operations. This would be essential in accurately reflecting business activities in Illinois. Similarly, in order to properly measure its business activities in the United States it must also apply the "80-20" in Section 1501(a)(27) by using the formula in Section 304(c) but using only business income which is attributable to its U.S. operations. Should Entity B pass the "80-20 test" it and Entity A **would** form a unitary business group in Illinois necessitating the filing of a combined return.

I hope that this has been helpful to you. I apologize again for any inconvenience which this might have caused you. If you have additional questions please feel free to contact myself or Paul Caselton the Associate Chief Counsel for Income Tax at the above address.

Sincerely,

Charles E. Matoesian
Associate Attorney (Income Tax)